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SOBERING UP AND GOING GLOBAL: BRAZIL'S PROGRESS FROM POPULISM AND PROTECTIONISM

Peter Kingstone*

OVER the course of the last two decades, Brazil has made an impressive progression in terms of its economic policy and performance. By the early 1980s, the "Brazilian Miracle" was decisively over, and the "country of tomorrow" was reeling from a cluster of severe economic problems, including rising inflation, deepening balance of payments problems, sluggish growth, and crippling external debt. In 1985, the combination of economic problems contributed to the end of the military regime that had overseen the "miracle years." The miracle was premised on strong state-leadership and import-substitution-industrialization (ISI), but by the end of the dictatorship, it was clear that this basic formula had to change. Unfortunately, the new democracy also struggled initially to develop a coherent approach to solving the country's deepening economic problems. The election of Fernando Collor in 1990 did finally usher in a new direction as Collor embraced neoliberal economic reforms, especially privatization and trade liberalization. Nevertheless, the transition was anything but smooth or consensual, and the resulting political turbulence did little to resolve the economic crisis. In fact, Brazil's political and policy performance was so erratic that the *Economist* magazine observed that the country's problems were the result of it being "drunk, not sick."¹

As of 2008, the situation has changed dramatically. Brazilian economic and social policy is widely praised for its stability, innovativeness, and adherence to prudent macroeconomic principles. And though Brazil's economic performance continues to lag behind the region's leaders, it is dramatically improved relative to its own past performance, with the trend pointing towards continued improvement. It is important to note that this dramatic change occurred under the government of Workers' Party President, Luiz Inacio Lula da Silva. The one-time socialist labor leader has eschewed populist or more radical leftist policies and instead has championed a reformist, moderate-left strategy premised on macroeconomic stability. Thus, Brazilian democracy has "sobered up"

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1. Jim Rohwer, *The Blessed and the Cursed; The Only Thing Standing Between Brazil and Asia-like Rates of Economic Growth Is Lousy Government. Jim Rohwer Asks Whether It Will Kindly Get Out of the Way*, *ECONOMIST*, Dec. 7, 1991 at 3.

from its early confused and confusing start at managing the economy. Indeed, a wide consensus exists across the political system on the need for less state management and more sensible, non-inflationary macroeconomic policies.²

The need to contain inflation was probably the most important cause of the shift in the approach to economic policy, but the approach to trade policy has also experienced a significant philosophical shift within Brazilian policy circles. Historically, since the onset of the Great Depression, Brazil had been a closed country, as evidenced by its annual trade amounting to (roughly) only 6 to 8 percent of GDP. The country's industrial sectors were heavily protected through both tariff and non-tariff barriers, while agricultural competitiveness was systematically undervalued and undermined. By contrast, Brazilian trade in 2007 accounted for roughly 25 percent of GDP, and import tariffs had fallen to an average of 14 percent from an average of 112 percent during the 1980s.³ In addition, a liberalized agriculture sector has boomed, leading to large increases in exports of products such as soy and meat. The dramatic increase in Brazilian trade reflects a newfound belief in its value as a critical element of the country's growth strategy. Thus, the Brazil of 2007, with its commitment to macroeconomic stability and openness to trade, was dramatically different from the Brazil of twenty years ago.

The question this paper addresses is: how and why did this shift happen? I argue that the most important element driving this process of change was the concern over inflation. The need to reduce inflation and keep it low fueled a process of political learning, on both the right and the left, about the value of sound macroeconomic policy *and* the important role that trade plays in the macroeconomic policy. Macroeconomic stability is not the *only* factor that accounts for Brazilian attitudes toward trade. For example, Brazilian policy makers, especially those within the powerful foreign ministry (Itamaraty), have long viewed Brazil as a regional power, with these views continuing to be important.⁴ Furthermore, the protectionist and statist beliefs summed up by the word "*desenvolvimentista*" (developmentalist) are still present among Brazilian policy makers and business elites. Macroeconomic concerns remain paramount, however, and basic policy decisions—from social policy to foreign policy—tend to be subordinate to macroeconomic priorities. The emphasis on the macro economy helps to account for both the degree of openness of the Brazilian economy as well as the limits of the willingness to

2. Timothy J. Power, *Centering Democracy? Ideological Cleavages and Convergence in the Brazilian Political Class*, in *DEMOCRATIC BRAZIL REVISITED* (Peter Kingstone & Timothy J. Power eds., forthcoming Oct. 2008).

3. Ministério de Desenvolvimento, Indústria, e Comércio Exterior, <http://www.mdic.gov.br> (last visited Mar. 2008).

4. See Maria Regina Soares de Lima & Monica Hirst, *Brazil as an Intermediate State and Regional Power: Action, Choice, and Responsibilities*, 82 INT'L AFF. 1, 21-40 (2006).

make further concessions in the interests of greater integration.⁵

I make this case in five sections. As background for understanding the shift, Section I examines Brazil's strategy for economic growth at the time of the transition to democracy. This section also examines the new democracy's initial efforts to both address Brazil's economic crisis and consider alternative development strategies. Section II examines the initial shift in orientation towards neoliberal reforms, including trade liberalization, and discusses the "drunkenness" of the political process at the time. Section III discusses the "sobering up" phase of Brazilian politics—when political consensus on macroeconomic policy began to emerge and the country's neoliberal model began to consolidate. Section IV discusses the current administration of Luiz Inacio Lula da Silva and the consolidation of the country's growth strategy into a pragmatic version of neoliberal reforms. This section explores Brazil's increasing openness to trade and its importance to the economy, as well as the sources of continued reservations about deepening trade integration, particularly through the Free Trade Agreement of the Americas. Finally, the concluding section, Section V, discusses the implications of Brazil's stance towards continued trade integration and the sources of concern regarding the sustainability of Brazil's growth strategy.

I. CLOSED AND DRUNK: SLOUCHING TOWARDS INTEGRATION

In the early 1980s Brazil was in difficult straits. The military regime that had led the country out of economic chaos in the 1960s and into the "miracle years" of 1967-1974 had lost the credibility to govern. The military had tried to cope with the oil shock of 1973 by borrowing heavily and growing the economy out of its difficulties. With the second oil shock of 1979 and a debt crisis emerging in 1982, the military regime was out of answers. The hopes of Brazilian *grandeza* (greatness), built upon dynamic state leadership and a powerhouse industrial economy, were beyond the capacity of the military's economic team. Their failures helped contribute to a loss of political support even amongst the regime's most important civilian supporters in the business and financial communities.⁶ By 1983, the military had fallen back on orthodox economic measures to contain inflation and restore some measure of order to Brazil's external accounts. Other than this, the military had neither the vision nor the political support to implement a new economic strategy.

Some state technocrats in the National Development Bank (BNDES), however, began to formulate a proposal for economic reform after con-

5. See André Averbug, *Brazilian Development Bank, Brazilian Trade Liberalization and Integration in the 1990s* (1999), <http://www.bndes.gov.br/english/studies/trade.pdf>.

6. LUIS CARLOS BRESSER-PEREIRA, *O COLAPSO DE UM ALIANÇA DE CLASSES* (Editora Brasiliense 1978); JEFFRY FRIEDEN, *DEBT, DEVELOPMENT, AND DEMOCRACY: MODERN POLITICAL ECONOMY AND LATIN AMERICA, 1965-1985* (Princeton University Press 1991).

sidering Brazil's need to shift its growth strategy.⁷ The concern among these BNDES economists was that the Brazilian economy was falling behind the rest of the world technologically. In their view, the economy was divided between competitive and modern sectors on the one hand and backwards and uncompetitive sectors on the other. The competitive and modern sectors were losing ground in the global economy because of the state's disorder and the resulting loss of investment capacity. The uncompetitive sectors, while not aware of their backwardness, were important because this group's noncompetitiveness was a drag on economic growth. The solution, in the economists' view, was to turn away from import-substitution-industrialization and instead seek greater integration with the global economy—but on Brazil's terms. The strategic objective of this "competitive integration" was to close the gap between the modern and backwards sectors and increase the overall competitiveness of the Brazilian economy.⁸ Thus, competitive integration envisioned selective trade liberalization as an element within a larger set of industrial policies. The government of José Sarney (PMDB, 1985-1989) announced a new industrial policy in 1988 that incorporated the competitive integration philosophy, including selective, limited liberalization, within its proposals, though ultimately, this incorporation amounted to little.

Unfortunately, no strategy was capable of producing results in the absence of macroeconomic stability, and the New Republic that emerged out of the transition from the dictatorship appeared at the onset to be even less capable of governing the economy than the military. From 1985 to 1989, the economy suffered terribly. Inflation rose from roughly 600 percent in 1985 to over 80 percent per month by the inauguration of President Fernando Collor in March of 1990. On virtually every economic indicator, Brazil was suffering from bad performance or high levels of volatility, or both. Brazilian policy makers appeared incapable of changing course.⁹

The source of the policy makers' difficulties was primarily political. Brazilian politics in the New Republic created several distinct challenges. First, the restoration of democratic rule opened the door to new demands from groups neglected or suppressed under the military. In turn, these newly mobilized groups offered tempting targets for populist appeals. In particular, Sarney manipulated his first and most important stabilization effort, the Cruzado Plan, for partisan political gain at the expense of the

7. The BNDES was the state's principal arm of development financing and promotion and an important center of technocratic capacity.

8. BANCO NACIONAL DE DESENVOLVIMENTO ECONÔMICO E SOCIAL, *INTEGRAÇÃO COMPETITIVA: UMA ESTRATÉGIA PARA O DESENVOLVIMENTO BRASILEIRO* (Nov. 1989); Luiz Paulo Vellozo Lucas, Chief of the Planning Dept., Banco Nacional de Desenvolvimento Econômico e Social, *Integração Competitiva: Uma Nova Estratégia para a Industrialização Brasileira*, Paper Presented at the United Nations Industrial Development Organization Technical Meeting (1989).

9. See WERNER BAER, *THE BRAZILIAN ECONOMY: GROWTH AND DEVELOPMENT* (Praeger 1995).

coherence and effectiveness of the plan.¹⁰ Short-term positive results translated into success in the 1987 mid-term elections for the PMDB. Inflation, however, returned with renewed energy almost immediately afterwards. Sarney's government introduced multiple stabilization plans from 1988 until the end of his term in office, but all of them failed, due at least in part to a lack of political ability to make hard choices.¹¹

Sarney's problem lay in the character of the political system as it emerged from the dictatorship. The party system began to fragment almost immediately after the transition, growing from a handful of parties (mainly the Social Democratic Party (PDS), the Party of the Brazilian Democratic Movement (PMDB), and The Workers' Party (PT)) to nearly twenty parties with legislative representation. In addition, party and electoral system rules weakened party discipline and intensified the incentive to cultivate personal votes, especially within the lower chamber.¹² Together, the fragmentation and personalization weakened presidential authority vis-a-vis the Congress and increased the need for patronage spending. As re-establishing macroeconomic stability depended, at least in part, on reining in expenditures, Sarney's efforts to solve inflation were not supported in the legislature.

Finally, in addition to Sarney's populist efforts and the political system's tendency toward fiscal indiscipline, the new constitution badly exacerbated the situation. The new constitution was written from 1987 through 1988, and the leftist and nationalist groups that mobilized more effectively in the early rounds of draft writing influenced its character. As a consequence, the constitution contained articles detailing extensive social and labor rights, limiting interest rates, and closing off important segments of the economy to foreign investment. Furthermore, the document reflected the desire of its drafters to undo the centralizing character of the dictatorship. Perhaps the most important result of this desire was that the constitution mandated the transfer of revenues to states and municipalities without requiring related spending obligations by the revenue recipients. Thus, the new constitution enshrined nationalist and statist economic principles while creating a kind of perverse fiscal federalism that profoundly compromised the fiscal health of the state.¹³ Sarney's failure to advance any kind of meaningful reform of economic policy is perhaps not much of a surprise in hindsight. Successful reform would have to await a new president.

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10. Lourdes Sola, *Heterodox Shock in Brazil: Técnicos, Politicians, and Democracy*, 23 J. OF LATIN AM. STUD. 163, 163-95 (1988).
 11. Luis Carlos Bresser-Pereira, *Populism and Economic Policy in Brazil*, 33 J. INTERAM. STUD. & WORLD AFF., 1, 1-21 (1991).
 12. SCOTT MAINWARING, *RETHINKING PARTY SYSTEMS IN THE THIRD WAVE OF DEMOCRATIZATION: THE CASE OF BRAZIL* (Stanford University Press 1999).
 13. Alfred Montero, *Devolving Democracy? Political Decentralization and the New Brazilian Federalism*, in *Democratic Brazil: Actors, Institutions and Processes* (Peter Kingstone & Timothy J. Power eds., University of Pittsburgh Press 2000).

II. OPENING UP . . . BUT STILL DRUNK

The 1989 presidential elections offered two contrasting choices of the future direction of Brazil. On one hand, Luiz Inacio Lula da Silva, a one-time labor leader and a founder of the Worker's Party (PT), offered a program based on nationalism and socialism. Lula articulated intense distrust of the United States, multinational corporations, and large firms in general. His competitor was Fernando Collor (PRN), the son of an elite northeastern family who ran on a populist-style platform that was short on specific proposals and long on symbolism and rhetoric designed to mobilize the resentment of the poor. Though short on specifics, Collor did clearly signal two priorities. First, he promised to kill inflation with a single bullet. Second, he vowed to modernize Brazil—to turn it into a sleek, efficient “Brazil incorporated.” Thus, the 1989 election featured an explicit choice between nationalism and socialism on the one hand and neoliberalism on the other. From an elite (notably business) perspective, neither candidate was desirable.¹⁴ Socialism was certainly not an option, but neoliberalism was a long way from “competitive integration.”

Collor won the election, decisively beating Lula among the poorest and least educated voters and losing to him in every other category. Collor had won the votes of the poor based on his pledges to combat inflation and his dramatic neopopulist attitudes towards elites. One observer opined that Collor had won by running against elites, but now he would have to govern with them.¹⁵ But Collor's desire to advance a neoliberal agenda was not very popular among elites. The combination of a very small base in Congress (due to the fragmentation of the system) and an economic agenda that ran counter to many elite interests (on both neoliberalism and containing inflation) made Collor's situation perilous.

What Collor did have on his side was a high level of popular approval, especially as he began his assault on inflation. Collor's solution to inflation was a drastic plan designed to dramatically curtail inflation with a single blow. It was a plan that reflected the difficulties Brazilian presidents faced in crafting enduring, programmatic legislative coalitions. The Collor Plan was launched shortly after his inauguration in March 1990, after declaring a bank holiday. The government then announced sharp restrictions on bank withdrawals, effectively freezing roughly 80 percent of the country's money supply. The plan had several elements in its favor. It had an immediate effect on inflation while its burden—unlike most stabilization plans—fell disproportionately on wealthier citizens (those with more in the bank). The reduction in inflation added to Collor's popular approval, which he wielded like a weapon against the recal-

14. PETER KINGSTONE, CRAFTING COALITIONS FOR REFORM: BUSINESS PREFERENCES, POLITICAL INSTITUTIONS, AND NEOLIBERAL REFORM IN BRAZIL (Pennsylvania State University Press 1999).

15. *Id.*

citrant congress.¹⁶ With his popular approval, Collor pushed a neoliberal reform agenda through a quiescent and timid congress. This included privatization plans, wide-ranging deregulation, cuts in government spending, and the implementation of a gradual, ordered, and thorough trade liberalization plan.

Trade liberalization was an important part of the modernization of the economy, but falling protection also had important anti-inflationary effects by reducing domestic producers' freedom to pass on rising costs to consumers. Average tariffs began a scheduled four-year reduction program, with tariffs on basic inputs and capital goods falling first and fastest while the most heavily protected consumer goods sectors, such as automobiles, had additional time to make competitive adjustments in anticipation of increased import competition. Tariffs for capital goods and equipment that were not produced locally were reduced to 0 percent immediately. In addition, the Collor administration sought to eliminate non-tariff barriers, ease import and export regulations, and ended the market reserve for computers.¹⁷ In short, Collor pursued a significant, unilateral trade liberalization that included a reasonable adjustment timeframe for domestic producers. In this respect, the program was distinctly different from some of the more notable, drastic Latin American trade liberalizations, such as the ones that occurred in Chile and Argentina in the 1970s.

Industrialists in previously protected sectors had mixed views of the Collor Plan. On the one hand, many of them recognized that the Brazilian economy had to open up and that the scheduled tariff reduction process was reasonable. The government encouraged and supported business associations and *sindicatos* (syndicates, for the sake of uniformity) to become more involved in the dissemination of information about new methods of quality production and identification of trade partners. On the other hand, many of these same industrialists observed that trade liberalization without the accompanying macroeconomic stability and without complementary policies that depended on a fiscally healthy state (such as infrastructure investment and deeper capital markets) was simply a recipe for de-industrialization. Industrialists protested vigorously for things like reform of Brazil's notoriously inefficient and burdensome cascading taxes on production (as well as income and payroll taxes). In short, industrialists' support was contingent on Collor's efforts to improve the state's fiscal health.¹⁸ Unfortunately, Collor made little headway on this last front.

Collor was aware of the need to address the root causes of Brazil's fiscal mess (and, ultimately, inflation). Solving these larger issues meant

16. Kurt Weyland, *The Brazilian State in the New Democracy*, 39:4 J. OF INTERAM. STUD. & WORLD AFF. 63, 63-94 (Winter 1997-1998).

17. GESNER OLIVEIRA, *CONDICIONANTES E DIRETRIZES DE POLÍTICA PARA A ABERTURA COMERCIAL BRASILEIRA* (IPEA Research Project, CEBRAP, São Paulo, Brazil 1991).

18. See KINGSTONE, *supra* note 14.

addressing constitutional sources of fiscal imbalance as well as attacking the elite interests—in the congress and in state and local governments—that protected the ongoing fiscal crisis. But, to do that, Collor needed to forge a stable legislative coalition out of a highly fragmented and personalistic legislature. By late 1990, it was clear that Collor's single bullet to kill inflation had missed, and inflation, driven by the deep structural problems he was hoping to address, was resurgent.¹⁹ With inflation returning, Collor's strategy of reform "by imposition" on the Congress was no longer viable.²⁰ Instead, the Congress turned on the increasingly unpopular Collor and derailed his policy program. By early 1992, Collor's legislative agenda was finished.

Although Collor's administration ended in legislative failure (and then scandal, corruption, and impeachment in 1992), he had successfully changed the direction of Brazil's economy and its growth strategy. Though Brazil's policymaking elite had not become ideological neoliberals, there was much wider acceptance of the need to enhance the competitiveness of the local economy by opening to trade. Even Lula began campaigning in the mid 1990s on "competitive integration" as opposed to old-ISI style, nationalist state-led growth.

The new orientation to trade was cemented in the negotiation of Mercosur, the agreement that established a free trade zone among Argentina, Brazil, Paraguay, and Uruguay under the Treaty of Asuncion in 1991. Mercosur was an ambitious project that envisioned the zone's eventual development into a customs union and then common market.²¹ It envisioned a political strategy of mutual defense of democracy and the creation of a strong institutional framework. The first, and easiest, steps were not to take place until 1994; however, in the meantime, Brazil remained plagued by intolerably high levels of inflation and considerable fiscal disorder.

III. GETTING SOBER, CLOSING TRADE

Between December 1992, when Collor was impeached on corruption charges, and January 1995, Itamar Franco, Collor's Vice President, governed the country. Franco was not sympathetic to the neoliberal direction and did little to advance Collor's agenda. He did nothing to reverse it, however. In fact, Franco's only notable achievement as president was to appoint Senator Fernando Henrique Cardoso (PSDB) as Finance Minister, who in turn put in place the plan that definitively tamed inflation in Brazil: the Real Plan.

Cardoso's success was built on learning from successive failures at stabilization under both Sarney and Collor. Virtually all the early efforts

19. Ben Ross Schneider, *Brazil Under Collor: Anatomy of a Crisis*, 8:2 *WORLD POL'Y J.* 321, 321-47 (1991).

20. See Weyland, *supra* note 16.

21. Jeffrey Cason, *On the Road to Southern Cone Economic Integration*, 42:1 *J. OF INTERAM. STUD. & WORLD AFF.* 23, 23-42 (2000).

(seven in total) at solving inflation through the first two governments of the new democracy involved some element of populist manipulation of economic policies. The aim in each of the many efforts was to solve inflation with one dramatic, highly intrusive shock coupled with some kind of progressive or populist element to shield one segment of voters or another.²² One of the last finance ministers of the 1980s, Mailson da Nobrega, observed critically that Brazil needed surgery, but successive finance ministers kept giving the country anesthesia.²³

These attempts played a critical and instructive role for both policy makers and citizens.²⁴ Policy makers came to understand that shocks of any kind simply were not going to work, both because they did not address all the real underlying roots of inflation and because they lacked credibility in the public mind.²⁵ They came to understand the central importance of government credibility in any effort to contain inflation. On the other hand, voters had learned to distrust the shock elements of anti-inflation plans as well as the populist trappings and offerings in which they had been wrapped. Voters had become deeply intolerant of inflation but wary of their government's magic promises.²⁶

By 1993-1994, this learning process prepared the way for a definitive end to high inflation.²⁷ Cardoso's Real Plan differed in four crucial ways. First, it addressed all the root causes of inflation. Second, it was debated openly in Congress and in public and was therefore highly transparent

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22. See Bresser-Pereira, *supra* note 11. As noted earlier, a critical reason for the reliance on shock plans was that the political system fragmented between 1985 and 1989, going from a small handful of political parties to nineteen parties with representation in Congress (and over thirty parties competing in the presidential election). The difficulty in constructing reliable and durable legislative majorities encouraged Brazil's presidents to rely on decree authority and dramatic gestures that did not depend on consistent legislative participation and endorsement.
 23. Norman Gall, Fernand Braudel Institute of World Economics, *The Floating World of Brazilian Inflation* (1991), available at http://www.normangall.com/publiclist/art_brazil.htm.
 24. Between 1985 and 1990, successive Finance Ministers implemented the Cruzado Plan, the little Cruzado Plan, the Plan of Rice and Beans, the Summer Plan and, in what was the most aggressive and invasive plan of all, the Plano Collor. The failure of the Collor Plan less than 6 months after implementation effectively ended the possibility that voters would tolerate (or believe in) any future shock plan in Brazil.
 25. Luis Carlos Bresser-Pereira, *Economic Reforms and Economic Growth: Efficiency and Politics in Latin America*, in *ECONOMIC REFORMS IN NEW DEMOCRACIES: A SOCIAL-DEMOCRATIC APPROACH* (Luis Carlos Bresser-Pereira et al. eds., Cambridge University Press 1993).
 26. See *Id.*; Leslie Armijo, *Mass Democracy: The Real Reason that Brazil Ended Inflation?*, 33:12 *World Dev.* 1993, 2013-28 (2005); Leslie Armijo & Philippe Faucher, *We Have a Consensus: Explaining Political Support for Market Reforms in Latin America*, 44:2 *LATIN AM. POL. & SOC'Y* 1, 1-40 (2002).
 27. Brazilian inflation was particularly hard to solve because it had both orthodox, monetarist origins as well as inertial ones. Thus, Brazilian policy makers had to address excess demand and government spending, but also had to eliminate the institutionalized memory of inflation in the formal system of price indexation introduced in the 1960s. Previous stabilization efforts, dating back to the military's use of purely orthodox austerity measures in the 1980s, had generally focused on one source or the other.

and thus considerably more credible. Third, it was introduced gradually, allowing actors time to adjust their expectations and their contracts. The final difference was the centerpiece of the Real Plan: the creation of a new unit of value with which to adjust prices and contracts, the URV (unit of real value), which was anchored loosely to the dollar. The URV was then converted to a new currency, the *real*, on July 1, 1994. At the time the Real Plan was introduced, inflation was over 15 percent per month. Yet, within three months of introduction, the rate of inflation fell below 2 percent per month and continued to spiral lower. Riding on the plan's success and his ability to claim credit for it, Cardoso entered the 1994 presidential elections and swept to victory.²⁸

The plan committed the government to a managed exchanged rate regime in order to maintain the credibility of the currency.²⁹ As a result, Cardoso's plan, like Collor's before him, depended on a lasting structural reform that would address the state's underlying sources of fiscal imbalance. Cardoso initiated the Real Plan with a short-term fiscal adjustment negotiated in Congress, the Social Emergency Fund (in addition to benefiting from Collor's fiscal adjustment efforts and trade liberalization). In addition, Cardoso launched a negotiated process to recuperate the state's long-term fiscal capacity in exchange for short-term patronage rewards.³⁰ In the short to medium term, however, the stability of the *real* rested on the credibility of the government's commitment to protect the value of the currency—in short, to guarantee that there were sufficient reserves to back the linkage of the currency to the dollar.

To ensure that there were sufficient reserves, the Cardoso government was forced to adopt a number of measures that preserved macroeconomic stability, but had other undesirable consequences. These included renewed privatization to bring in fresh inflows of foreign capital and a high real interest rate policy to maintain such flows. High real interest rates discouraged investment and led to rising public sector debt. This, coupled with an overvalued currency (as a consequence of its linkage to the dollar), hurt agricultural exports, and encouraged imports,

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28. Antonio Manuel et al., *Eleição Presidencial: O Plano Real na Sucessão de Itamar Franco*, 2 OPINIÃO PÚBLICA 1, 39-48 (1995). The effect of the Real Plan on voting was remarkably clear. Lula led in public opinion polls throughout 1994 and was widely seen as the likely winner of the 1994 elections. He campaigned actively against the Real Plan, deriding it for its orthodox elements and predicting dire consequences for the poor, even as it began to take effect in July of 1994. Cardoso, however, was not able to capitalize on the benefits of the Real Plan until the end of August, when Brazil's free TV hour for political campaigns began and Cardoso was able to start claiming credit for the increasingly successful and popular plan. The polls reversed dramatically through September and October leading to a crushing victory for Cardoso over the still-critical Lula. The shift in polling and its coincidence with Cardoso's identification with the plan is tracked clearly in Teixeira, Manuel and Venturi, 1995.
 29. Gesner Oliveira, The Brazilian Economy under the Real: Prospects for Stabilization and Growth, Paper Presented to the Latin American Studies Association (Sept. 28, 1995); Albert Fishlow, *Is the Real Plan for Real?*, in BRAZIL UNDER CARDOSO (Susan Kaufman et al. eds., 1997).
 30. See Weyland *supra* note 16.

which threatened the current account, domestic industry, and the ability of the government to protect the value of the *real*.

To cope with the threats to macroeconomic policy, the Cardoso administration partially reversed course on trade liberalization on three fronts. First, the administration passed an industrial policy for the auto sector that significantly raised tariffs on imported vehicles while including a number of powerful incentives to encourage exports from the sector. Second, the administration increased tariffs on a number of other important sectors and products. Finally, the administration used Mercosur to increase external common tariffs and provide higher levels of protection for a host of industrial goods. Mercosur, in fact, provided Brazil with both a market for an increasing number of industrial exports as well as an additional layer of protection for its domestic industries and its current account balance. As a consequence, average tariffs increased substantially between 1995 and 2002, as did the average dispersion among them.³¹

The return to selective protectionism did not equate to an embrace of traditional Brazilian state-led, inward-oriented development. In fact, the Cardoso administration was divided over the issue of trade and industrial policy. On one side, advocates of a more neoliberal approach, notably Finance Minister Pedro Malan, preferred less protectionism and more limited state intervention in the economy. By contrast, the more nationalist “competitive integration” view continued to find its voice in both the industrial community and within the cabinet, led most notably by the Minister of Planning, José Serra. In general terms, Malan and the neoliberal voices were considerably stronger, which showed particularly in the area of macroeconomic policy. Thus, the Cardoso administration’s industrial policies and use of Mercosur as an additional shield was less a victory of the Serra wing of the cabinet than it was a recognition of the risks open trade posed to macroeconomic stability.

But the contradictions of the Real Plan eventually came to a head. Cardoso made significant efforts to restore the Brazil’s long-term fiscal health, including important changes in transfers to states and local governments as well as the creation of a new tax on financial transactions. These efforts were insufficient, however, to counter concerns about the government’s capacity to maintain the *real* at rough parity with the dollar. After a successful defense against a run in October 1998, the administration lost the battle in January 1999, and the Real Plan ended, as the currency was sharply devalued and then allowed to float. The ensuing period leading up to the 2002 elections was one of relatively erratic economic performance as the country suffered the consequences of the shock. Cardoso had put to rest concerns about ungovernability and drunkenness and set the country on a clear path for the future. But, in the short term, the path to stability remained a difficult one.

31. See Averbug *supra* note 5.

IV. STABILITY, OPENNESS AND THE FUTURE OF TRADE

This increasing economic uncertainty was the context in which the 2002 presidential elections took place. Despite Cardoso's achievements—not the least of which was the taming of Brazil's historically high rates of inflation—all of the major presidential candidates ran against his record, including Cardoso's handpicked successor and former cabinet member, José Serra. Soon into the campaign, Lula emerged as a virtually unassailable front-runner. He was running on a platform that explicitly criticized Cardoso's neoliberalism and called for an "inversion of priorities" to undo Cardoso's "cursed legacy." The PT platform had changed over the course of the 1990s from its earlier fairly unapologetic anti-capitalist stance. Nevertheless, it continued to reflect strong commitments to redistributive policy, social justice, and serious mistrust of global capitalism (and the United States).

Not surprisingly, both foreign and domestic investors watched the campaign unfold nervously. Over the course of 2002, Brazil's risk premium rose in response to growing concerns about the possibility of default on the debt and the *real* devalued by roughly 50 percent. Cardoso's second term saw deteriorating fiscal and current accounts, sharply rising public sector debt, rising real interest rates (over 20 percent), and rising inflation (though still very low by Brazil's historical standards). Though unemployment was the number one concern among voters, the growing macroeconomic uncertainty led to a sharp increase in voter concern regarding resurgent inflation.³² Lula's stated priorities suggested that his administration would make little effort to protect the macroeconomic stability that had been the chief priority of the Cardoso administration.³³

To counter the growing concern about the possibility of his electoral victory, Lula issued a public "Letter to the Brazilian People" in June of 2002.³⁴ The letter reaffirmed his criticisms of the Cardoso administration and his commitment to social justice. But it also acknowledged the risks of resurgent inflation and the need to meet existing debt obligations. Thus, the letter's audience was both domestic voters and foreign and Brazilian investors. Lula needed to give notice to voters that his administration would have to put the "inversion of priorities" agenda on hold in the interest of guarding against inflation. He also needed to credibly signal his commitment to macroeconomic stability to Wall Street and Avenida Paulista.

This shift in Lula's priorities reflected his political learning over the

32. Rachel Meneguello, *Government Popularity and Public Reaction to Social Security Reforms*, 17 INT'L. J. OF PUB. OPINION RES. 1, 173-189 (2005).

33. Aline Diniz and Jonathan Kreickhaus, *The Limits of Economic Reform in Brazil*, in DEMOCRATIC BRAZIL REVISITED (Peter Kingstone & Timothy Power eds., University of Pittsburg Press forthcoming Oct. 2008).

34. Letter from Luis Inácio Lula da Silva, President of Brazil, to the Brazilian people (2002), available at <http://www.pt.org.br>.

course of the 1990s.³⁵ Lula had run for president in every presidential election since the restoration of democracy in 1985. In each election, a right wing (Collor, 1989) or center (Cardoso, 1994 and 1998) candidate defeated him on the backs of poor voters. Lula, a working class hero and son of very poor northeastern migrants to São Paulo, was more popular among middle class and educated voters, as well as the organized working class (both white and blue collar), than he was among the voters that should have been his natural base. One crucial reason for this outcome was his and the PT's failure to understand the importance of inflation to low income voters. In fact, in 1994, Lula actively campaigned against the Real Plan as a neoliberal program that would reduce the purchasing power of the poor by 30 percent. Instead, the plan's success at reducing inflation provided one of the fastest and most effective reductions of the rate of poverty in modern Brazilian history. Inverting priorities and social justice resonated well among the social movements and the organized labor base of the PT, but low inflation mattered to low-income voters.³⁶

As a result, Lula moved to strongly signal his commitment to fiscal discipline and macroeconomic stability. With the failure of the Real Plan, macroeconomic management shifted from exchange rate control to explicit inflation targeting.³⁷ Lula preserved this orthodox macroeconomic orientation and went further to signal his commitment to orthodoxy by appointing two well known, highly regarded market-oriented figures to key positions: Henrique Meirelles as President of the Central Bank and Antonio Palocci as Finance Minister. He publicly announced a primary surplus target of 4.5 percent of GDP, which considerably exceeded even the IMF's suggested target. Finally, he embraced a set of economic and social reforms designed to improve the fiscal health of the state, even though they also harmed core constituencies of his own party. The most important of these was a reform of the pension system for public sector employees—a policy attempted under Cardoso (with meager success) and one that the PT had fought against bitterly. In fact, the pension reform was so controversial that four members of the PT party were expelled after voting against it in the Congress, and more members left PT

35. Wendy Hunter, *The Normalization of an Anomaly: The Workers' Party in Brazil*, 59:3 *WORLD POL.* 341, 440-475 (2007); Hunter, 2007, notes that PT party leaders were influenced both by the 1994 defeat and by Cardoso's crushing 1998 first round victory. The lessons to the party leadership were clear about the need to be pragmatic and forego radical reform in favor of protecting macroeconomic stability. Barbosa-Filho, the Secretary for Economic Monitoring in the Ministry of Finance under Lula, also notes that the government's central objective was rapid disinflation and continued inflation-targeting against its potential recurrence.

36. Note that this does not mean that inflation was in fact the key factor in presidential elections—although it does appear to have been definitive for 1994—or that inflation is an accurate predictor of voting behavior. The claim of the importance of inflation does not rest on tests of economic voting across the various elections. What does matter is that PT leaders believed that inflation and managing the macro economy were tremendously important to low-income voters and as a consequence shifted their policy orientation and political strategy.

37. Nelson Barbosa-Filho, *Inflation targeting in Brazil: 1999-2006*, 22:2 *INTL. REV. APPLIED ECON.* 187 (2008).

of their own volition in anger.³⁸

Since 2002, Lula's commitment to macroeconomic stability has only deepened, even after containing the immediate crisis of 2002. In fact, Lula reaped rapid economic rewards for his orthodox policies. Growth, per capita growth, and inflation all looked bad in 2003, but by 2004, the economy was improving dramatically. GDP growth increased from roughly 1 percent in 2003 to over 5 percent in 2004, while GDP per capita growth increased from negative .25 percent to over 4 percent. Inflation fell from over 14 percent to under 7 percent. In addition, the value of the *real* not only recovered but also appreciated against the U.S. dollar, while both the current and fiscal accounts improved significantly. The performance of the Brazilian economy looked particularly good in comparison to the Cardoso period (see Table 1).

Strong economic performance has reinforced Lula's commitment to macroeconomic stability, and his administration continues to rely on inflation targeting as its central macroeconomic policy tool—something that has cost Lula's party the support of its traditional base. Social movements, which had long constituted the party's organizational compensation for more limited financing, have withdrawn support. Brazil's Landless Rural Workers' Movement (MST) and the public sector unions have withdrawn their automatic allegiance.³⁹ To counter these developments, Lula cultivated and received support from the biggest beneficiaries of macroeconomic stability: low-income and low-education voters of the north and northeast.⁴⁰ This group became Lula's key electoral base in the 2006 presidential election, constituting a dramatic shift away from his 2002 base in the organized working class and middle class of the south and southeast voters.

But Lula's rewards came from good fortune as well as sound macroeconomic policy. The global economy had begun growing much faster after 2003, fueled by demand from India and especially China. In addition, Lula was a beneficiary of the end of the Real Plan, as evidenced by the devalued currency and the floating exchange rate regime leading to sharp improvements in Brazil's trade performance. Trade as a percent of GDP increased every year after the 1999 shock, from around 15 percent in 1998 to a high of 29 percent in 2004 (and then falling slightly to an

38. Peter Kingstone & Aldo Ponce, *The Performance of Leftist Governments in Latin America: From Cardoso to Lula: The Triumph of Pragmatic Neoliberalism in Brazil*, Paper Presented at the Theresa Lonzano Long Institute of Latin American Studies at the University of Texas, Austin: (Mar. 6-7, 2008).

39. Kathryn Hochstetler, *Organized Civil Society in Lula's Brazil*, in *DEMOCRATIC BRAZIL REVISITED* (Peter Kingstone & Timothy Power eds., University of Pittsburgh Press forthcoming Oct. 2008).

40. Wendy Hunter & Timothy J. Power, *Rewarding Lula: Executive Power, Social Policy, and the Brazilian Elections of 2006*, 49:1 *LATIN AM. POL. & SOC'Y* 1 (2006); Lourdes Sola, *Politics, Markets and Society in Lula's Brazil*, 19:2 *J. OF DEMOCRACY* 5, 31-45 (2008).

TABLE 1. COMPARING CARDOSO'S AND LULA'S PERFORMANCES: ECONOMIC INDICATORS

Economic indicators	1995	1996	1997	1998	1999	2000	2001	2002	Average Cardoso	2003	2004	2005	2006	Average Lula
GDP growth (annual %) ^a	4.4	2.2	3.4	0.0	0.3	4.3	1.3	2.7	2.33	1.1	5.7	2.9	3.7	3.35
GDP per capita growth (annual %) ^a	2.87	0.63	1.83	-1.45	-1.22	2.79	-0.13	1.21	0.82	-0.25	4.27	1.57	2.44	2.01
GDP per capita, PPP (constant 2000 international \$) ^a	6,977	7,021	7,150	7,046	6,960	7,154	7,145	7,231		7,213	7,521	7,639	7,826	
Trade (% of GDP)	16.0	14.9	15.8	15.9	20.2	21.7	25.7	26.7	19.62	27.1	29.0	26.7	26.4	27.3
Inflation ^b	66.67	15.71	6.17	3.49	4.49	7.53	7.00	8.41	14.65	14.66	6.77	6.34	4.64	8.10
Investment rate (as % of GDP) ^c	16.5	16.4	17.3	17.2	15.7	15.8	15.7	14.5	16.14	13.7	14.1	14.2	15.0	14.25

Sources: (a) World Bank, World Development Indicators; (b) International Monetary Fund (IMF), International Financial Statistics; (c) IPEADATA Statistics

average of roughly 27 percent in the years since).⁴¹ Brazilian trade has increased dramatically in all categories of trade, including basics, semi-manufactured, and manufactured goods. Brazil's performance on trade has been a critical element in the country's macroeconomic stability, as evidenced by historic current account deficits turning into large surpluses. In turn, these surpluses have allowed Brazil to progressively retire its foreign, dollar-denominated debt. As of 2008, Brazil still has considerable net public sector debt, but its foreign debt has been retired completely.

Trade policy under Lula, as with Cardoso, has become an important element in the maintenance of macroeconomic stability. Under Cardoso, a partial and selective retreat from liberalization while promoting exports (both industrial and agricultural) was a critical protection against the high real interest rates and overvalued currency that, at the time, was the bedrock of macroeconomic performance. Cardoso's cabinet was divided on the nationalist-liberal question, with the liberal side generally being dominant, selective protectionism notwithstanding.

Lula's cabinet also reflected similar tensions. Nationalist and statist ideas still exist in Brazil, and, generally Lula's foreign policy has had a decidedly nationalist orientation.⁴² Under Lula, the nationalist economic perspective was championed by José Dirceu, while the Finance Minister, Palocci, played the role of defender of liberal policies. Again, like Cardoso, the liberal wing of Lula's administration has dominated on economic matters, especially since Dirceu's political fall in the corruption scandals of 2005-2006.

In general terms, the approach towards trade has been similar between the Cardoso and the Lula administrations, as evidenced by much greater trade liberalization than in the past, with selective protection for key industrial sectors. Trade has become a critical element of Brazilian economic performance and a central part of macroeconomic stability. For those reasons, neither Cardoso nor Lula was particularly eager to negotiate the Free Trade of the Americas Agreement (FTAA). The FTAA promised greater integration with the U.S. market, without promising lib-

41. Ministério de Desenvolvimento, Indústria, e Comércio Exterior, <http://www.mdic.gov.br> (last visited March, 2008).

42. See Soares de Lima, *supra* note 4. Soares de Lima and Hirst distinguish between one side that seeks greater international credibility and another that seeks greater autonomy. The credibility seekers look to work within existing institutions, creating new rules, accepting Brazil's power limits, and seeking to maintain orthodox macroeconomic commitments. By contrast, the autonomy seekers look to create new institutions, enhance Brazil's autonomy and prestige, integrate development goals with foreign policy, and challenge US influence in the region. For Soares de Lima and Hirst, the macroeconomic orientation looks very much the same between Cardoso and Lula, but they argue that the autonomy side has prevailed under Lula and thus explains the vigorousness of Lula's "South-South" strategy. They have a broad focus on foreign policy across a number of domains, while mine is limited to macroeconomics and trade. In the more limited sense that I focus on, I believe the economic policy orientation continues to reflect a pragmatic liberal dominance despite the significant shift towards a "South-South" strategy analyzed by Soares de Lima and Hirst.

eralized access for key agricultural products, while simultaneously demanding greater access in industrial sectors and services. In short, the FTAA, as presented to Brazil, posed a potential threat to Brazil's current accounts coupled with the possibility of real losses in critical industrial sectors.⁴³

Under Cardoso, international conditions were difficult and the administration felt pressure to proceed cautiously with the FTAA negotiations, generally preferring multilateral arrangements and bargaining between blocs. In particular, the administration did not want the United States to selectively pull Brazil's regional partners away from existing regional blocs such as Mercosur, whose member countries constituted a growing market for Brazilian exporters. With both the *real* and the *peso* similarly overvalued, the exchange rate did not affect Brazilian exports, and trade within Mercosur increased considerably over the 1990s, growing to more than 20 percent of Brazilian trade. Yet, the collapse of the Real Plan in 1999 destabilized the trading relationship with Argentina (with trade falling to roughly 10 percent of total trade), and the growing economic crisis in both countries, coupled with the generally weak institutional framework of Mercosur, made it a weak reed to stand on as an alternative to the FTAA.⁴⁴

Conditions for Lula have been quite different. With global growth and trade expanding in the 2000s, the whole region has been growing. Mercosur has expanded to include Venezuela, Chile, and Bolivia as associate members, and trade within the region has boomed (although the Latin American Integration Association (ALADI) continues to represent only about 11 percent of trade, with Argentina accounting for most of it). In addition, trade with India and, especially, China has provided Brazil with new markets for its goods.⁴⁵ Furthermore, Lula has traveled abroad frequently seeking new commercial ties in other developing regions, such as Africa and the Middle East. In short, the expansion of global trade has made a "South-South" strategy an attractive option to both the FTAA and acquiescence to U.S. and European preferences in the WTO. The Brazil-led G-20 (the developing nation negotiating bloc) has been able to stand as a front against OECD preferences for increased access to Southern markets without reciprocal easing of restrictions on agricultural trade.⁴⁶

43. Jeffrey Hornbeck, *Brazilian Trade Policy and the United States*, Congressional Research Service (Feb. 3, 2006), available at: <http://digital.library.unt.edu/govdocs/crs/permalink/meta-crs-9138>; Marcelo de Paiva Abreu, *The FTAA and the Political Economy of Protection in Brazil and the US*, Institute for the Integration of Latin America and the Caribbean & Integration, Trade and Hemispheric Issues Division, Working Paper-SITI- 12, Mar. 2006).

44. Mario E. Carranza, *Mercosur and the End Game of the FTAA Negotiations: Challenges and Prospects after the Argentine Crisis*, 25:2 Third World Q. 277, 319-327 (2004).

45. Fernando Pimentel Puga, Brazilian Development Bank, *A Inserção do Brasil no comércio mundial: o efeito China e potenciais e especialização das exportações* (2005), <http://www.bndes.gov.br/conhecimento/publicações/catalogo/td.asp>.

46. See Soares de Lima, *supra* note 4.

While the “South-South” strategy has been available to Lula, it is not clear how effective it has been for Brazil. The Lula administration has tried to use these various options as increased leverage against the United States in particular, with limited impact ultimately. This is because the United States and the European Union remain vital markets for Brazilian exports, with total trade between Brazil and those entities significantly exceeding trade with Mercosur (or ALADI, more broadly). In addition, ongoing Argentine-Brazil trade tensions have continued to limit Mercosur’s deepening as a common market, and thus, Mercosur continues to represent a weak reed for bloc bargaining. Nor has Brazil succeeded in leveraging greater access to the European Union and reducing its considerable protection of agriculture. Finally, as recent negotiation failures in the Doha Round demonstrate, even the G-20 has had limited capacity to alter U.S. and European agricultural protectionist policies.

Although Brazil’s regional and “South-South” strategy has had limited success, Lula’s selective liberal trading policy has not only been good for growth and macroeconomic performance—it has also been good politics. Public opinion polls show that Brazilians are relatively supportive of free trade and correctly identify it with lower prices for consumer goods.⁴⁷ Nevertheless, anti-U.S. sentiment and resistance to imperialism feed into “auto-estima” (self-esteem) feelings prevalent within Brazil (including among elite policy-makers), and the FTAA is widely unpopular among the general public for its perceived unfairness.⁴⁸ As a result, Lula pays a small price, politically or economically, for his reluctance to pursue unilateral liberalization or deeper integration with the United States through the FTAA. As long as these basic political and economic conditions prevail, Brazilian presidents face very weak incentives to change this stance.

V. CONCLUSIONS

Brazil has changed enormously since the 1980s. The country’s political and policy-making elite has come to a relatively consensual embrace of pragmatic neoliberalism, a deep commitment to sound macroeconomic policies, and an acceptance of open trade as a real benefit to Brazil. This is a dramatic and impressive change. But it is also one that presents clear limits to the possibility of further trade integration with the United States.

This does not mean that Brazil could not benefit from reviewing these policies. Lula’s Brazil has benefited from his commitment to macroeconomic stability, but he has also benefited from a particularly auspicious global context (unlike his predecessor, Cardoso). Brazilian politicians can maintain their policy commitment, but they continue to face challenges to that commitment and obstacles to long-term, sustaina-

47. Andy Baker, *Consuming the Washington Consensus: Mass Responses to the Market in Latin America* (Cambridge University Press forthcoming).

48. Sean W. Burges, *Auto-estima in Brazil: The Logic of Lula’s South-South Policy*, 60:4 INT’L J. 897, 1133-1151 (2005).

ble growth. Perhaps more importantly, the global good times are certainly not going to last. When they do come to a close, Brazilian competitiveness, both domestically and in global markets, will matter much more.

The problem for Brazil is that macroeconomic stability continues to depend on high real interest rates that attract capital as an offset to enduring structural impediments to fiscal health. In particular, the country's grossly inequitable and bloated public sector pension system is a significant drain on the treasury. Although interest rates have come down from the highs of the late 1990s, they are still uncompetitive and constitute a drag on economic growth and domestic investment. High real interest rates, in turn, help maintain an uncompetitive exchange rate, despite real improvements on that front since the late 1990s. The competitiveness of the economy also suffers from labor market rigidities, which have been and will continue to be very difficult to reform, and an inefficient, burdensome tax system that falls too heavily on production in the formal sector of the economy, which is another difficult area to reform due to the state's reliance on the revenues from these taxes. Yet, both of these circumstances drag on the performance of the economy. In fact, Brazil's performance under Lula looks excellent when compared to Brazil's past economic performance. But the cluster of factors noted above has hurt Brazilian economic performance in relation to the rest of the region. Compared to Argentina, Peru, or Chile, for example, Brazil's performance looks sluggish.

The problem has been, and continues to be, the subordination of microeconomic concerns to macroeconomic ones. As Gesner Oliveira observed, the constant privileging of macroeconomic concerns leads to contradictions in the micro-economy that translate into uncompetitive consequences.⁴⁹ The same observation could be extended to trade policy. Brazil has legitimate concerns about trade and the FTAA. It is not unreasonable to expect that the OECD markets will reciprocate on key agricultural sectors. But trade as a tool of macroeconomic policy has meant it is sub-optimal as a tool to support and promote increased microeconomic competitiveness. Even in agriculture, where liberalization has been greater and has existed longer than in industry, performance has been lower than expected with critical sectors like coffee underperforming.⁵⁰ Thus, in the final analysis, Brazil's policy elites are split between a liberal group that favors open trade as part of a larger vision of economic development and those that envision selective opening of trade as part of an industrial policy approach to development. Ultimately, neither has prevailed as macroeconomic concerns have driven

49. GESNER OLIVEIRA, *CONDICIONANTES E DIRETRIZES DE POLÍTICA PARA A ABERTURA COMERCIAL BRASILEIRA* (IPEA Research Project, CEBRAP, São Paulo, Brazil 1991).

50. Steven M. Helfand & Gervásio Castro de Rezende, *The Impact of Sector-Specific and Economy-Wide Policy Reforms on the Agricultural Sector in Brazil: 1980-1998*, 22:2 CONTEMP. ECON. POL'Y 1, 194-212 (2004).

trade policy choices. Unfortunately, the long-term competitiveness of the domestic economy ends up paying the price.

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